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No. 151

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960

JOHN T. JARECKI, former Collector of Internal Revenue, et al.,

Petitioners,

vs.

G. D. SEARLE & CO.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

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BRIEF FOR THE RESPONDENT IN OPPOSITION

Opinions Below

The opinion of the court of appeals is reported in 274 F. 2d 129. The district court's findings of fact, conclusions of law, and summary judgment (R. 43-48)[1] are not officially reported.

Jurisdiction

The judgment of the court of appeals was entered on January 27, 1960 (Pet. 14). The petition for a writ of cer-

1. Record references are to the Appendix to respondent's brief in the court of appeals.

tiorari was filed on June 16, 1960. The time within which to file this brief in opposition was extended to and including September 1, 1960. The jurisdiction of this Court has been invoked under Section 1254 of the Judicial Code.

Question Presented

Is respondent entitled to a trial on the merits of its suit for refund of excess profits tax under the provisions of Section 456 of the Korean War Excess Profits Tax Law, granting relief for certain statutory classes of income designated as abnormal income? Respondent asserts that income resulting from its discovery of two break-through drugs affecting completely new treatments for illness qualifies for relief under this statute.

Statute and Regulation Involved

Section 456 of the Excess Profits Tax Act of 1950, which is no longer in effect (see 67 Stat. 175), provided in pertinent part (64 Stat. 1137, 1186; Section 456 of the Internal Revenue Code of 1939, 26 U.S.C. 1952 ed., § 456):

"SEC. 456. *Abnormalities in income in taxable period.*

"(a) *Definitions.*—For the purposes of this section—

"(1) *Abnormal income.*—The term 'abnormal income' means income of any class described in paragraph (2) includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 115 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

"(2) *Separate classes of income.*—Each of the following subparagraphs shall be held to describe a separate class of income:

"(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

"(B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months; or

"(C) Income from the sale of patents, formulae, or processes, or any combination of the foregoing, developed over a period of more than 12 months; or

"(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's method of accounting.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary."

* * * * *

Section 40.456-2(b) of Treasury Regulations 130 (as amended by Treasury Decision 6026 of July 3, 1953) provides as follows:

"Other income, not within a class described in subparagraphs (A)-(D) of section 456 (a) (2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456 (a) (2) as are reasonable in a business of the type which the taxpayer conducts, and as are

appropriate in the light of the taxpayer's business experience and accounting practice. Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise properly includible within a class of income to which such section is applicable, for example, the class described in section 456 (a) (2) (D)."

Statement

Contrary to the opening sentence of the statement in the petition for certiorari, the facts are in dispute. Many crucial facts are disputed (p. 5 of March 31, 1959, transcript; see R. 53). However, certain other facts are established by the record. Respondent G. D. Searle & Co., a pharmaceutical company, seeks to recover part of the excess profits taxes paid for the years 1950 through 1952 on income resulting from its discovery of two drugs, Banthine and Dramamine (R. 3-17). Summary judgment was entered against respondent (R. 48) despite its insistence that factual issues are involved and evidence required to support its claim.

This proceeding involves respondent's right to tax relief under the Korean War Excess Profits Tax Act for income resulting from discovery of two drugs, Banthine and Dramamine. This Act permits special treatment of income resulting from discovery if the income falls within a class of "abnormal income" specified by the Act. If part of such "abnormal income" is attributable to other years, the statute allows mitigation in some degree of the full excess profits tax impact.

One of the district court's orders in this proceeding limited the substantive issue to the determination of the character or class of respondent's income from these discoveries. Other issues raised by the requirements of the Act, such as the computation of the amount of abnormal income and the years of attribution, have all been held in abeyance. (R. 27-28.)

Respondent appealed from a summary judgment rendered for petitioners by the district court (R. 48). The district court held that respondent's drugs were "products arising out of research and development and as such specifically prohibited by Congress from being considered discoveries within the meaning of Section 456(a)(2)(B)" (R. 46). Respondent also contended in the alternative that even if its income from the discoveries of Dramamine and Banthine was not the result of "discovery" within the meaning of Section 456(a)(2)(B), it constituted a separate class of abnormal income granted relief under the last sentence of Section 456(a)(2) (R. 45). The district court held, however, that "income from the sale of tangible property arising out of research and development may not be classified as abnormal" under any theory (R. 47).

Since this case arose on appeal from a summary judgment, the record contains few of the facts which respondent intended to establish at the trial. Dramamine is a new drug for the relief of motion sickness and Banthine a new drug for the treatment of peptic ulcers. Respondent advised the district court of its intent to prove that both Dramamine and Banthine were break-through discoveries involving new compositions of matter, and that their effect on the body constituted an unprecedented approach to the treatment of motion sickness and peptic ulcers (see Transcripts of both district court hearings, R. 53). Contemporary medical lit-

erature and other publications termed these two drugs *discoveries*, for, unlike all of respondent's other products, they were not improvements on existing drugs (cf. R. 3, 31-40). Their large sales and widespread imitations were further indicia that these drugs were genuine discoveries.

In the alternative, respondent intended to prove at the trial that it was "reasonable" and "appropriate" within the meaning of the applicable Treasury Regulations to treat the income from Dramamine and Banthine as abnormal under the last sentence of Section 456(a)(2) even if it did not qualify as "discovery" income under Section 456(a)(2)(B), since these drugs were utterly dissimilar from any of respondent's other products (see R. 3-4).

Respondent's income and excess profits tax payments during the three years in question totaled $19,093,230.47 (R. 19, 20). Of this amount, the complaint sought to recover approximately $3,600,000 under the abnormal income provisions of the Korean War Excess Profits Tax Act (R. 44).

Concluding that factual issues were presented, the court of appeals reversed the summary judgment and held that respondent should be permitted to prove whether Dramamine and Banthine are actually discoveries (Pet. 13). The judgment of the court of appeals did not determine that respondent is entitled to recover any particular amount: only that respondent be given an opportunity to prove its case. The judgment leaves to the trial court all questions of determination of existence of abnormal income, including the complicated statutory computation of amount (see R. 5-6, 27-28).

ARGUMENT

Correctly holding that summary judgment was improper until the facts could be developed, the court of appeals has remanded this case for trial. Thus the issues are not ripe for adjudication here nor is a true conflict of decisions presented. Moreover, the statute involved expired in 1953, so that the question presented is of insufficient importance to warrant review by this Court.

1. No final judgment has been rendered. The court below has not decided that respondent is entitled to any recovery. The court felt that all the facts should be developed before a final ruling is made and that it would certainly be wrong to decide novel questions of law in a vacuum. Cf. *American Securit Co.* v. *Hamilton Glass Co.*, 254 F. 2d 889, 892, 893 (C.A. 7, 1958). Its holding is only that respondent should not be prevented by summary judgment from proving that Dramamine and Banthine are "discoveries" within the relief provisions of Section 456(a)(2) of the Korean War Excess Profits Tax Act (*supra*, p. 3). A litigant's opportunity to prove essential facts must not be cut off by summary judgment. *Sartor* v. *Arkansas Natural Gas Corp.*, 321 U. S. 620, 627; *Fountain* v. *Filson*, 336 U. S. 681; *United States* v. *Western Pacific R. Co.*, 352 U. S. 59, 75-76. Here the essential facts are sharply controverted.[2] Because of the summary judgment which respondent strenuously opposed, respondent had no opportunity to show that both these products were break-through discoveries, involving new compositions of matter not in existence before respondent discovered them (R. 30, 41, 44), and that each affected

2. Petitioners themselves so asserted, when they advised the district court that "we [the parties] disagree as to the facts" (p. 5 of March 31, 1959 transcript; see R. 53). The right of either party to introduce evidence at the trial was preserved (R. 26) because petitioners finally proved unwilling to stipulate as to facts that respondent considered essential.

the human body in an unprecedented way in relieving motion sickness and peptic ulcers. Respondent was also foreclosed from proving in the alternative that it was "reasonable" and "appropriate" under the applicable Treasury Regulation (*supra*, pp. 3-4) to treat the income from these two drugs as abnormal under the last sentence of Section 456(a)(2) of the Act (see R. 3-4).

As in both courts below, petitioners' principal contention is that neither Dramamine nor Banthine income can qualify for relief since both products resulted from research and development (Pet. 3, 4-5; R. 43, 45). Petitioners' contention that all income arising from research and development is excluded from relief under Section 456 is untenable. In July 1953 the Treasury refused to promulgate a proposed regulation to that effect (17 F. R. 10973) and instead issued the present regulation which states positively that Section 456 is applicable to income from research and development if the income fits into one of the classes to which Section 456 applies.[3] Concededly, discovery income is one of such classes. If petitioners were correct that no research or development income can come within Section 456, discovery income could not qualify for relief even though Section 456(a)(2)(B) expressly accords relief to such income! Petitioner's statement that the Seventh Circuit regarded "discovery" as "broad enough to include anything which is the result of research and development" (Pet. 4) is inaccurate. The opinion of the court of appeals clearly recognized that "absent the element of discovery, income resulting from research or development does not by reason of the latter factors qualify for treatment as abnormal income" (Pet. 12). The decision below merely held that

3. See Section 40.456-2(b) of Treasury Regulations 130, as amended by Treasury Decision 6026 of July 3, 1953 (1953-2 Cum. Bull. 235), *supra*, pp. 3-4.

"income resulting from discovery is not under the terms of subparagraph (B) of [Section 456(a)(2) of] the statute precluded from classification as abnormal income merely because research and development may have occasioned, or have been factors which contributed to, the discovery" (Pet. 12).

Although the common and statutory use of "discovery" has not been confined to the mining industry,[4] petitioners also contend that "discovery" in Section 456 means only discovery of natural resources through mining (Pet. 5). Congress did not so specify, nor does the legislative history support petitioners. Actually in the 1940 predecessor statute, "discovery" occurred in the phrase:

> "Income resulting from exploration,[5] discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, *or any combination of the foregoing* * * *" (54 Stat. 974, 986; 55 Stat. 17, 22; Section 721 of the Internal Revenue Code of 1939, 26 U.S.C. 1952 ed., § 721; italics supplied).

According to their genesis, the associated words thus unequivocally show Congress was not limiting relief to mining operations under the 1940 statute (see, *e.g.*, *W. B. Knight Machinery Co.*, 6 T.C. 519 (1946); *Rochester Button Co.*, 7

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4. See, *e.g.*, Sections 151-155, 157-158 of the Atomic Energy Act (42 USC §§ 2181-2185, 2187-2188); Section 517(a)(1) of the Mutual Security Act (22 USC § 1668(a)(1)); and Section 5(i) of the Tennessee Valley Authority Act (16 USC § 831d(i)).

5 The term "exploration" is not confined to a narrow geophysical meaning. Thus in I Oxford English Dictionary (1933 ed.), exploration is defined as follows (p. 657):

> "1. The action of examining; scrutiny—1655. 2. *Med.*, etc. The examination of an organ, a wound, etc. by the use of the finger, a probe, or the like 1860. 3. The action of exploring; an instance of this 1823."

In Webster's New International Dictionary (Unabridged 2d ed.) "explore" is defined as follows (at p. 898):

> "1. To seek for or after; to strive to attain by search."

T.C. 529 (1946)), and Congress gave no indication in 1950 that it suddenly intended to confine relief to the mining industry. Furthermore, *noscitur a sociis* may not be employed to limit the plain meaning of a word. *Russell Co.* v. *United States*, 261 U. S. 514, 519-520; *Wong Kam Wo* v. *Dulles*, 236 F. 2d 622, 626-627 (C.A. 9, 1956); 2 Sutherland, Statutory Construction (3d ed.) § 4908 at pp. 393-394. The plain meaning of discovery would include rare pioneer or break-through drugs such as these. For example, Webster's definition of discovery includes "(a) Finding out or ascertaining something previously unknown or unrecognized; as Curie's *discovery* of radium" (Webster's New International Dictionary (Unabridged 2d ed.) p. 745). In fact, when Congress was considering the instant statute, certain drugs which were also responsible for radical changes in the field of medicine were described by a witness at the hearings in terms of "discoveries":

> "The discovery or development of another aureomycin or another ACTH or of a cure for cancer during the taxable year must be encouraged and not penalized" (Hearings before the Senate Finance Committee on H.R. 9827, 81st Cong., 2d Sess. (1950), p. 709).

Entirely new chemical compounds of medical value were deemed to be discoveries in *Smith, Kline & French Laboratories* v. *Clark & Clark*, 157 F. 2d 725, 729 (C.A. 3, 1946), certiorari denied, 329 U. S. 796, and *Wisconsin Alumni Research Foundation* v. *George A. Breon & Co.*, 85 F. 2d 166, 167, 171, 172 (C.A. 8, 1936). The Treasury Department has also concluded that drugs can qualify as discoveries within Section 456(a)(2)(B), for it recently settled a claim involving a popular antibiotic, a product of one of respondent's competitors. In the present case the examining officer of the Internal Revenue Service concluded that at least Dramamine was a discovery within the ordinary meaning of the

word (R. 31, 54). In the absence of clear indications of contrary intent, "words used in legislative enactments • • • are to be given their known and ordinary signification" rather than a limited or special meaning. *United States Gypsum Co.* v. *United States*, 253 F. 2d 738, 744 (C.A. 7, 1958), acq. Rev. Rul. 58-593; see also *Commissioner* v. *Marshall's Estate*, 203 F. 2d 534, 537 (C.A. 3, 1953); *United States* v. *Merchants National Bank*, 261 F. 2d 570, 575 (C.A. 5, 1958).

There is no reason for believing that Congress wished to give a limited, special meaning to the term discovery and thereby eliminate income from such pioneer or breakthrough discoveries as Dramamine and Banthine from the class of income which, under Section 456(a)(2)(B), was entitled to certain mitigation of the excess profits tax. On the contrary, an examination of the policy behind Section 456 adds further force to the argument that respondent's discoveries fall within the terms of the law. The main objective of the excess profits tax was to tax profits attributable to the large military budget and a profitable wartime economy. As the House Report stated:

> "One of the main objectives in imposing an excess profits tax is to reach corporate profits which have been swollen by the increased tempo of the economy. An excess profits tax selects for additional tax those corporations whose profits are higher than they probably would have been in the absence of hostilities and a large military budget." (H.R. Rep. No. 3142, 81st Cong., 2d Sess. (1950) (1951-1 Cum. Bull. at p. 187)).

In providing relief in exceptional situations such as those indicated by Section 456(a)(2), Congress recognized that in some instances high profits would not be attributable to military spending and the generally higher wartime econ-

omy. Section 456 should be construed to take this into account, as was its World War II predecessor:

> "Congress anticipated that business for many taxpayers would improve because of external changes and it intended the tax to apply in those cases. It also realized that there might be some instances in which the income of the base period years might not satisfactorily reflect internal changes in the business. That is, there might be cases in which the increase in profits of the tax year over those of the base years might be attributed, at least in part, to internal changes and development of a particular business or some phase of that business to its full stature and to that extent would not be attributable to the outside business stimulus." *Soabar Company*, 7 T.C. 89, 96 (1946).

Unless the income from respondent's discoveries falls within the abnormal income relief provisions of Section 456(a)(2), the coincidence that the discovery of Dramamine and Banthine occurred shortly before the outbreak of the Korean War would operate to penalize respondent in a way which Congress did not intend. These drugs had nothing to do with the war. Respondent's discoveries, because they were new and useful advances in medicine, would have resulted in abnormal income to the discoverer in peacetime as well. This income was the result of "internal changes and development of a particular business" (7 T. C. at p. 96); it was not a case of income "swollen by the increased tempo of the economy" as a whole (1951-1 Cum. Bull. at p. 187). Actually the volume of sales increased dramatically after hostilites had ceased (see R. 23).

Moreover, the discovery of these drugs, like most other discoveries of new products, resulted from years of effort and expense which were brought to fruition during the excess profits tax period (see R. 3, 4, 6). The competitive advantage of a new discovery lasts only a short time.

Recognizing the unfairness of bunching for heavy taxation in one year discovery income which is in fact attributable to several years, Congress intended that such abnormal income from discovery, if it can be shown to be attributable to other years, should be taxed accordingly. All respondent seeks is an opportunity to prove that its income in question was in fact attributable to other years and therefore entitled to relief. Certainly Congress was aware of the common meaning of the word "discovery", and if it had felt that "discovery" of minerals, etc. was more deserving of relief legislation than a "discovery" of vital importance to the health of millions of individuals, it would have so stated. See *Commissioner* v. *Quartzite Stone Co.*, 273 F. 2d 738, 739 (C.A. 10, 1959), certiorari not authorized, 1960 P-H Fed. Taxes ¶ 56,370.

2. The alleged conflict of decisions does not exist. Here the ruling of the court of appeals will merely grant respondent its day in court and permit evidence as to whether or not Dramamine and Banthine are discoveries within Section 456. Further, the court of appeals found it unnecessary, and expressly declined, to pass upon respondent's alternative contention that respondent be allowed to show that its income should be placed in a separate similar class permitted by the last sentence of Section 456 and the Treasury Regulation issued thereunder. *Polaroid Corporation* v. *Commissioner*, 278 F. 2d 148 (C.A. 1, 1960), presents no conflict because there the taxpayer had the trial to which it was entitled, with fully developed facts presented to the trial court. Then too *Polaroid* concerned an improved camera and film, whereas here involved are new compositions of matter not in existence before respondent discovered them (R. 3, 30, 41, 44) and operating in unprecedented ways on the human body (R. 3). There is no similarity whatever between improvements of camera and film designed for photographing humanity and break-through discoveries of remedies which provide great relief for human suffering.

CONCLUSION

This case does not involve any principle of general importance and the governing statute expired in 1953. The decision below properly held that taxpayer should not be prevented by summary judgment from developing essential factual issues at trial. No true conflict of decisions is presented. Accordingly, a writ of certiorari should not issue.

Respectfully submitted,

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